

THE AMERICAN CHAMBER OF COMMERCE
'GLOBALISATION AND THE FUTURE OF AUSTRALIAN
MANUFACTURING'

SPEECH: KIRBY ADAMS, MANAGING DIRECTOR & CEO

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Thank you to the American Chamber of Commerce. AmCham is, of course, Australia's largest international chamber of commerce. This is not only a reflection of the importance of the economic relationship between the two countries, but also of AmCham's very effective networking and events program.

As you might be able to tell from my accent, I am originally from the United States, although I have lived in Australia for eleven years and am now a proud Australian citizen.

I just got off the plane from the US this morning, after visiting BlueScope Steel's US operations, customers and partners. So I hope I can share some insights from that trip with you today.

The first piece of news I do have is that our Butler PEB business in the US, has just achieved its strongest shipment and profit performance in the past six months since we rescued the company from near bankruptcy in early 2004.

This is an impressive management turnaround, a great result, and we are very enthusiastic about the even greater potential of our larger North American businesses... more about this later.

Today, I intend covering three topics:

- Firstly, a brief overview of the global steel industry, including Australian steel companies such as BlueScope Steel, and the forces of globalisation that are acting to change the industry.
- Second, a 'health check' of the state of manufacturing in Australia.
- And finally, some thoughts about a more pragmatic government policy agenda to support manufacturing in Australia.

Please remember, manufacturing is Australia's largest source of employment and private sector R&D, and a major export earner.

I hope you don't mind if I take a few minutes to talk to you about the steel industry – and BlueScope Steel

BlueScope Steel is Australia's only global steel company, and one of Australia's largest manufacturers.

In fact, tomorrow is the fourth anniversary of our public listing on 15 July 2002 as a stand-alone manufacturing company. So although we have a 91-year history in steelmaking, we are, in fact, four years young as BlueScope Steel.

What a fantastic four years! In four years, we have repositioned this great Company from being primarily an Australian steelmaker and metal coater, to the leading global provider of steel building products and steel solutions.

Over these four years, we have performed for our shareholders.

Our Total Shareholder Return or 'TSR' ranks in the top quartile of ASX companies, with \$1.79 billion returned to shareholders since listing, and a share price increase of over \$5 per share.

After four years of aggressive expansion, we now operate 84 manufacturing plants in 17 countries. And we still have 10 major plants under construction in Asia.

Last week we started up our new \$100 million improvement to the Port Kembla Steelworks Hot Strip Mill – increasing capacity by 400,000 tonnes.

BlueScope Steel today employs about 18,000 people worldwide, up 60% from over four years. In that period, our workforce in Asia has grown from 400 to 4,000.

The result? BlueScope Steel is now Australia's largest investor and employer in Asia.

It is our fourth birthday today, and what excites us most is not what has happened in the last four years, but what is going to happen in the next four years.

Over in North America we have manufacturing facilities in 34 locations, and employ 4,100 people in that region, up from 200 four years ago.

Two years ago, we purchased the Butler pre-engineered steel building business for US\$221 million.

It was a business that was nearly bankrupt. But we saw great potential...

- in the market-leading BUTLER® brand
- in Butler's 100-year history and great reputation
- in its channels to market, and particularly the Butler Builder network
- in its great products

- and in its great people.

One year ago, we established a new regional management structure, closed a high cost plant in Illinois, and relocated it to a new state-of-the art facility in Tennessee.

On Tuesday, I had a BBQ with 300 employees at our newest plant in Jackson, Tennessee. A factory which did not exist 18 months ago, and is now making 1,000 tonnes a day over 95% on-time deliveries, and winning safety awards.

Today, North America is BlueScope Steel's second largest export market, by sales revenue, volume and profit.

Unquestionably, BlueScope Steel North America will be an Aussie success story, which demonstrates how a global thinking Australian company can go global.

In North America, BlueScope Steel has a great footprint for growth, and a clear strategic focus on growing our downstream businesses, supported by an excellent upstream hot rolled coil business.

So that is an overview of BlueScope Steel, but how do we fit into the global steel industry? And what are some of the trends that are reshaping the industry globally?

Well first, you should be aware that the Australian steel industry is tiny, compared to large steel producing nations such as China, Japan, Korea and Russia.

In fact, China now makes and consumes more steel than the four next largest producers - Japan, the United States, Russia and South Korea – combined.

In calendar 2005, China produced 349 million tonnes of steel products. That is up from only 100 million tonnes four years earlier. So that is an incredible growth rate, and a key driver of the current resources boom.

Australia, by contrast, produces a total of about 7.5 million tonnes of steel products per year. So China's steel production is more than fifty times that of Australia.

Despite Australia's relative small size, BlueScope Steel is - and can continue to be – globally competitive. For example, BlueScope Steel's Port Kembla Steelworks is in the lowest-cost quartile of global hot rolled coil producers. And unlike steel companies in our competitor countries, this is achieved with negligible government assistance and no raw material benefits.

Perhaps the most topical issue in the steel industry is consolidation of steelmakers.

This consolidation is being driven by the current fragmentation of the global steel industry, the search for economies of scale, and the battle against surging raw material costs.

Even after the merger of the two largest producers – Mittal Steel and Arcelor - the world's top five steel producers will only produce about twenty per cent of the world's steel.

Locally, just over a fortnight ago we saw the announcement that Smorgon Steel and OneSteel seek to merge.

These two companies are Australia's only two large producers of steel products like rod, bar, reinforcing mesh, and pipe & tube, and the two largest distributors of steel products in Australia.

A merger with these huge market share consequences is, of course, subject to scrutiny and approval by the ACCC. BlueScope Steel – like the rest of industry – knows it is vital Australia retains a competitive, innovative and viable steel sector in our economy. It is one reason BlueScope Steel is spending significant dollars on new plants and technology here in Australia.

So that is a snapshot of the steel industry. What about the Australian manufacturing sector as a whole? What kind of shape is it in, and what might its future look like?

One of my genuine concerns has been the continuing decline of manufacturing in Australia, and the lack of concern in Canberra.

Two decades ago, manufacturing comprised eighteen per cent of gross domestic product. Today, manufacturing comprises just thirteen per cent of GDP.

That is smaller, as a proportion of our economy, than the manufacturing sectors of New Zealand (19%), the United Kingdom (17%), and the United States (14%).

And it is much smaller than China, where manufacturing accounts for 39% of GDP (3x Australia).

While some sectors of Australian manufacturing have continued to thrive, there has been a significant reduction in the production of steel-intensive manufactured goods in Australia.

These jobs and industries are unlikely to ever return.

In the Australian automotive sector, retaining critical mass is essential if BlueScope Steel and others are to continue to invest, to meet the demanding requirements of automakers.

Ongoing closures amongst component manufacturers threaten to reduce the critical mass of the sector and its viability.

Elsewhere, imports of low cost canned foods by major grocery retailers, combined with skyrocketing raw material costs, have forced BlueScope Steel to close Australia's only tinsplate manufacturing plant.

Lest anyone think it is all darkness, there are some good news stories as well.

The domestic building and construction sector remains a strong market for BlueScope Steel, and steel is increasingly seen as the preferred building material. BlueScope Steel is working hard to grow steel market share in construction.

In the auto sector, BlueScope Steel has been very pleased to see the success of the Ford Territory – the only locally manufactured four-wheel drive vehicle. The Territory is made from steel manufactured by our Western Port plant here in Victoria.

BlueScope Steel is also supplying steel for the new Toyota Camry, to be launched in August, and for Toyota's new large car – the Aurion – to be launched in November.

There are also Australian success stories in industries as diverse as wind turbine manufacturing, draglines for mining, rail wagons, and steel power poles.

While these success stories should be celebrated, we must recognise that overall there has been a substantial 'hollowing out' of Australia's manufacturing capacity.

We believe this 'hollowing out' has worrying implications for Australia's future prosperity.

In our view, it is virtually unprecedented for an advanced OECD economy to have its manufacturing sector comprising less than 10 per cent of GDP. So we must ensure the sector does not get any smaller.

Despite its small size by world standards, manufacturing in Australia is still the largest employer, the largest investor in research and development, accounts for the largest share of merchandise exports by industry sector, and represents some of the best paying and highest skilled jobs.

And yet the voice of manufacturers is not being heard.

We believe it is vital that the 'unconscious drift' of manufacturing from Australia is halted, and that we do not accept its decline as a fait accompli.

To ensure this does not happen, a revitalised and carefully considered national reform agenda is needed, and needed now!

So what would be the key components of this reform agenda?

In my view, there are three critical elements:

- Firstly, a revitalised domestic microeconomic reform agenda
- Second, a more realistic and robust attitude to trade matters, and particularly to unfair trading behaviour
- And third, greater commitment by, and support for, Australian companies to go global.

So firstly, the domestic reform agenda...

I won't labour this point, because it is a point that has already been well made by organisations such as the Australian Industry Group and the Business Council of Australia.

But CEOs infrequently rattle this cage, so I will today...

There are, in my view, some urgent priorities...

1. We must continue to cut corporate taxes. Why? In order to ensure Australia is a competitive place for manufacturing investment. The benchmark here should be competitor countries in our region, not the high taxing economies of Europe.

For example, BlueScope Steel in China enjoys an effective tax rate of around 15 per cent, versus 30 per cent here!

2. We need to take steps to encourage research and development, in order to ensure Australian industry continues to innovate.

This could include making R&D tax concessions more effective and generous, and provisions to keep technology here in Australia for product development, manufacturing and export.

3. We urgently need to cut red tape. The BCA has noted that the stock of regulations – State and Federal – is currently growing at around ten per cent per annum, or more than twice the rate of GDP growth.

We need to ensure that the regulation of infrastructure is as efficient as possible, and encourage greater public and private sector investment.

If you think our airports, highways, and public transport are world class – go check out the real developed world.

Frankly, it is a national disgrace that in the 21st century, we still cannot move our steel products over one, unified rail system across Australia.

Let me now turn to trade policy...

I think in Australia some government leaders have been naïve in their approach to international trade.

Let's be realistic – we are a nation of only 20 million people

Yet we are caught up in ideology... In the fantasy that we can lead the world to a free trade 'nirvana', by unilaterally dropping our tariffs. It reminds me of unilateral disarmament in the 1960s – is that next?

While some people claim there are overriding benefits for those countries that unilaterally liberalise, there are massive costs for Australia's manufacturers, and for the millions of men and women employed by them.

Australia unilaterally liberalised its agricultural tariffs, but now finds it faces a stalled Doha trade round – stalled by the refusal of the Europeans and Americans to do likewise. – And we were inundated with EU subsidised Belgian peas.

Unilateral liberalisation is a precarious strategy. It means Australia has little to give away when negotiating bi-lateral trade deals.

Australia announced its intention to negotiate a bi-lateral FTA with China.

This FTA has the potential to deliver some benefits for some Australian companies.

In our view, however, FTA negotiations must also remedy some critical imbalances in the current trading relationship between the two countries.

A threshold issue for the Australian steel industry is the current imbalance in tariffs between China and Australia.

The Australian steel industry has very low levels of tariff protection, and negligible government support. In fact, most flat steel products are able to enter Australia from China tariff-free.

By contrast, Australian steel companies face tariffs of up to eight per cent, if they choose to export flat steel products to China.

This may not sound like a large barrier, but in a highly competitive global market, it is enough to make Australian steel products uncompetitive in China, the world's biggest market. That is one of the reasons why BlueScope Steel manufactures in-country in China.

We certainly support the legitimate aspirations of China to modernise its economy and raise living standards for its people.

But it is hard to argue that China is a developing country in relation to its steel industry, which is fifty times larger than Australia's, the world's largest by four times, and with most of that enormous capacity built within the last ten years.

Clearly, an Australia - China FTA that is designed to promote freer trade must ensure the current imbalance in steel tariffs is addressed immediately. Lower theirs, or raise ours to match – now.

In Canberra, I might be labelled a ‘protectionist’ for expressing these views.

OK. I do want to protect Australian shareholders, Australian jobs and future jobs, and Australian exports. Isn't that why we employ our governments? To protect us?

A fundamental objective of any FTA, or indeed of any multilateral trading system, must be to promote trade that is fair. That is, trade in which both parties adhere to some basic trading rules.

Let me be clear – BlueScope Steel supports free trade and open markets, underpinned by a rules-based trading system.

We were a strong supporter, for example, of the Australia – US Free Trade Agreement.

In that case, an FTA was an important tool in ensuring a more fair trading relationship for Australia's steel industry.

The Australia – US FTA is one factor underpinning the strong growth of BlueScope Steel's exports to the US. In fact, BlueScope Steel is now exporting more steel products to the US than ever before.

The story in China is, however, somewhat different. The Australian steel industry, and its manufacturing customers, do not want to see an amplification of the unfair trading behaviour of some Chinese manufacturers, which an FTA could bring.

I think it is correct to say that we remain to be convinced about the merits of an Australia – China FTA for Australian manufacturers.

Our view is that if Australian manufacturing is to prosper, it must go global, not try to crack domestic markets.

While some niche manufacturers may be able to survive by only servicing the Australian domestic market, the fact is, this market is too small for most – particularly if we persist with this zero tariff ideology.

Achieving scale – global scale – is essential to the competitiveness of most manufacturers.

In the steel industry, the threshold for global scale has been increasing every year. That is why we have been optimising our product mix, and undertaking incremental expansion, such as the expansion of our Hot Strip Mill at Port Kembla by a further 400,000 tonnes to nearly 3 million tonnes.

It is also one of the reasons we have expanded aggressively into Asia and North America – we are now selling products into markets of over 3 billion people, not 20 million.

In recent times we have been quite good at telling our Asian story, but perhaps not so good at telling our North American story.

So this occasion at AmCham is perfect.

The USA is now our largest export destination and, after Australia, our second-largest domestic market.

The acquisition of Butler has accelerated our global downstream strategy.

In just 26 months, we have turned around our Butler business from a loss making business to a winner.

Anyone can buy a well-run business by paying an outrageous premium. But our shareholders seek out value.

We are delivering that value, by cutting costs, improving safety, investing in new manufacturing facilities, and investing in our people.

These changes have begun to pay-off...

Our on-time delivery performance is now regularly above 95%, from about 50% two years ago.

We have successfully taken on new customers, such as the major retailer Costco.

We have grown our Butler Builder network.

And we have introduced innovative new products, from our Delta, Ohio Hot Rolled Coil plant.

The past two years have been a period of consolidation and turnaround. Our North American businesses are now well positioned to enjoy the improving US economy.

Our vision in North America is to be the leading supplier of flat steel building solutions – we are on our way.

And we will continue to look for investments that will further strengthen our global strategy and provide future returns for our shareholders.

BlueScope Steel's experience in North America is one example of how Australian companies can successfully go global.

Ladies and gentlemen, to conclude, let me return to the theme of my address and leave you with three clear messages:

– to globalisation, and the steps Australia must take to ensure our manufacturing sector succeeds in the global economy.

First, as a nation, we ignore Australia's manufacturing sector at our peril.

For the sake of our future prosperity, we must acknowledge the importance of our manufacturing sector...

in creating skilled, well-paid jobs,

in driving innovation across our economy,

in generating wealth for shareholders,

and in generating the exports that will sustain Australia beyond the current resources boom.

Second, governments need to be more robust, and more realistic, in their support for and respect for manufacturers.

State and Federal Governments need to drop their squabbling, and deliver a reinvigorated economic reform agenda.

Governments need to be prepared to drop ideology, and find pragmatic ways to support manufacturers, when it is in the interests of the country to do so.

And they need to take a tougher line with companies and trading nations who refuse to play by the rules.

And finally, Australian companies must look beyond the domestic market and integrate themselves into the world.

These are the steps we are taking to ensure our future prosperity.

Thank you for your time today.